THE AUSTRALIAN

Inquirer
FREE TRADE MYTHOLOGY

Paul Kerin, Richard Pomfret, Bill Carmichael, Glenn Withers, Greg Cutbush, Malcolm Bosworth, Martin Richardson, Richard Blandy
2,187 words
24 August 2016
The Australian
AUSTLN
Australian
11
English

As the multilateral Trans-Pacific Partnership teeters, seemingly opposed by both US presidential nominees, the economists below write to question the government's conduct of bilateral FTAs, which Malcolm Turnbull has described as part of his plan to promote prosperity

Paul Kerin Head, School of Economics, University of Adelaide Richard Pomfret Professor of Economics, University of Adelaide Bill Carmichael former chairman, Industries Assistance Commission Glenn Withers Professor of Economics, College of Business and Economics, ANU Greg Cutbush Visiting Fellow, Arndt-Corden Department of Economics, ANU Malcolm Bosworth Visiting Fellow, Arndt-Corden Department of Economics, ANU Martin Richardson Professor of Economics, College of Business and Economics, ANU Richard Blandy Emeritus Professor of Economics, University of Adelaide

A debate has raged for a decade about what we have gained from free trade agreements. We are now able to assess their contribution to future prosperity.

In each case, the information made available by the Department of Foreign Affairs and Trade about what we have gained has been highly positive, but without any basis in fact.

In each FTA completed to date the feasibility study released in preparation for negotiations projected the potential or possible gains for Australia. They did not, and could not, project what was actually achieved from the ensuing negotiations.

In each case, those projections were subsequently used to create an unreal public perception about the outcome of negotiations. The projections assumed that all or most of our trade barriers, and those of the negotiating partner, would be removed. This meant the gains projected at the outset conveyed nothing about what we achieved from the negotiations. Yet they were still quoted to support the agreements after they were signed, as though they reflected the actual outcomes for Australia.

As a result of this misleading process, each agreement has received public support, because we have had no basis for questioning the myth that each has brought enormous benefits to the economy. But that has now changed.

The Productivity Commission developed an analytical framework to assess the economy-wide effects of the bilateral agreement with the US (AUSFTA) in 2010, but at that stage not enough time had passed to enable a reliable, evidence-based assessment of the agreement's impact.

Australian National University economist Shiro Armstrong has now used the analytical framework developed by the Productivity Commission, and the decade of performance data since AUSFTA came into force, to conclude that "the data shows that ... Australia and the United States ... are worse off than they would have been without the agreement".

He says: "The agreement was responsible for reducing — or diverting — $53.1 billion of trade with the rest of the world." Armstrong's ANU colleague Peter Drysdale has measured that cost in terms we can all understand: "Australia alone has suffered trade losses the annual equivalent of the current price of around 18 Japanese, German, Swedish or French submarines through this deal." This does not mean a strong trading relationship with the US is not in Australia’s interests. But it does mean such a relationship, offering the substantial benefits promised, has not emerged from the agreement negotiated.

While we cannot now change how we negotiated the agreements with the US, Japan, South Korea and China, we can ensure that it does not reflect how we approach future negotiations.

The governance model that should guide trade policy is based on Australia’s conduct in the Uruguay Round of trade negotiations. It confirmed that the domestic decisions needed to secure the gains from liberalising unilaterally and in preparing for trade negotiations are the same.

The negotiations in the Uruguay Round took place at a time when Bob Hawke and Paul Keating were liberalising our own barriers unilaterally, to secure the efficiency gains involved. These reductions were subsequently offered, and accepted, in Uruguay negotiations as our market-opening contribution to global trade reform. As a consequence, we secured all the gains available from trade negotiations — the major gains in efficiency from reducing the barriers protecting our less competitive industries, as well as those available from access to external markets. That produced the win-win outcome we should be seeking from all trade agreements. It made a substantial contribution to the prosperity we have since enjoyed.

The opportunity to improve the performance of the economy in this way was missed in all FTAs concluded last year. In those negotiations, our agenda was simply a market access wish list; negotiations were conducted in secret; the outcome for domestic efficiency was determined solely by the market access arrangements negotiators happened to agree on, rather than a central objective in deciding which domestic barriers to reduce; and success was measured by whether the outcomes improved access to external markets.

When we fail to structure our market-opening offers to improve allocative efficiency, by reducing the barriers protecting our less competitive industries, we forgo the major gains available from negotiations. These efficiency gains strengthen the economy not by enabling us to “produce more” (that is, not by doing more of what we are already doing) but by moving from things we do less well to those we do better.

The consequences for domestic efficiency were demonstrated by the agreement with the US. We gained no worthwhile access for beef (in which we are world competitive) for the next 18 years, but secured immediate and unrestricted access to the US market for our motor vehicle industry (one of our least competitive industries).

If we are to close the gap between trade diplomacy and economic reality, we need to respect three lessons from experience: first, a major part of our gains from trade agreements depends on what we take to the negotiating table, not what we hope to take away from it; second, liberalising through trade negotiations cannot be pursued simply as an extension of foreign policy; and third, as the Harper report on competition policy has recommended, future bilateral agreements should be subject to cost-benefit analysis before ratification.

DFAT defends its approach, limited to negotiating access to external markets, on the grounds that the scope for reducing our own trade barriers has been exhausted. This is not supported by the facts. Although our border protection, in the form of tariffs, is now quite low, the Productivity Commission has reported that assistance to industry (that is, our remaining barriers to trade) was more than $17 billion in 2013-14. That does not include an unknown amount of hidden assistance in non-border forms. And we need only reflect on the present approach to dumping to recognise that the scope for removing domestic impediments to trade is far from exhausted.

Australia already has form on dumping. Austrade has for many years encouraged Australian producers to export at prices that recover marginal costs. When our Asian trading partners do that, we call it dumping. When we do it, we call it marginal pricing.

The effect of this double standard on relations with our Asian trading partners hardly needs to be spelled out. This year, 70 per cent of notices registered on our dumping authority’s website involve competition from our Asian trading partners. And more than 80 per cent of these involve China.

If we wish to develop a “transformational” trading relationship with China and other countries in the region, we will need to remove the double standard that pervades our present approach.

There is no conflict between the need for secrecy during negotiations and a process that provides transparency and a negotiating agenda that secures the efficiency gains available. Both requirements can be met by following the model established in the Uruguay Round.

That would involve the Productivity Commission providing a basis for Australia’s market-opening offers by conducting a public inquiry and reporting to government before future negotiations get under way. Its report would be released only when negotiations are complete. This would preserve secrecy during negotiations while providing for parliamentary and public scrutiny of the outcome before ratification. It would reflect the transparency arrangements that prepared the way for the reforms of the 1980s and 90s.

This change respects the logic underpinning market-based policy and our system of government. The logic providing the basis for market economics assumes the existence of well-informed consumers. The logic behind democracy assumes a well-informed community. Those responsible for articulating the theoretical basis for both — people such as John Stuart Mill, David Hume and Adam Smith — placed a condition on the relevance of each in enhancing the quality of governance and community welfare in countries practising them. The condition was, and remains, the existence of a well-informed community in the case of democracy and well-informed consumers as the basis for market economics.

That is the rationale for the domestic transparency arrangements established in Australia in the early 70s, structured to operate outside government and independent of private interest groups. Those arrangements were put in place to make our democratic system and market economics relevant in decision-making on protection issues, by providing the information governments, communities and consumers need to promote decisions that enhance community welfare.

The contribution of those transparency arrangements is to inform, not to manage, community understanding of what is at issue in opening domestic markets to international competition.

DFAT, and now government, has rebranded FTAs as "export agreements", further obscuring the clarity of what is at issue — securing the gains in national wealth from engaging in trade on the basis of what we do best. This simple logic has been corrupted into the language of trade negotiators, lawyers and consultants, unintelligible to ordinary folk.

It is evident in the language used to communicate trade policy developments. It is reflected, for instance, in the often stated proposition that Australia "fights above its weight" in trade forums. That is meant to convey that we cast a long shadow in trade circles and that we usually get more than we give in trade negotiations. Like pronouncements about "historic meetings" and "negotiating breakthroughs", it is part of the theatre that surrounds trade negotiations. It makes no contribution to community understanding of what is at issue in trade liberalisation, and it is this understanding that determines how much domestic liberalisation actually takes place.

DFAT's grip on trade policy has proved impervious to public challenge and will be removed only by strong political direction. Responsibility for introducing and explaining the need for change rests squarely with political leadership. It will require a preparedness to embrace (and explain to the rest of us) what is at issue for the economy and community, in language we can all understand.

A consequence of the modest change we suggest is to allow the community into the debate about trade policy. It would also remove the general disquiet about secrecy during negotiations, by providing a basis for public participation in agenda-setting before negotiations begin and for parliamentary scrutiny of negotiated outcomes.

It deserves a place in any policy framework to promote prosperity in the long transition from the resources boom to an uncertain future.

WHAT THE ECONOMISTS SAY AUSTRALIA-US FREE TRADE AGREEMENT A private consulting firm was engaged to assess the gains for Australia. That firm's first assessment, made before negotiations began, was used to suggest annual gains of $4 billion. This compares with probable gains of no more than $50 million estimated by the Senate committee established to review the outcome, after negotiations were complete. The original assessment assumed the negotiations would provide comprehensive access to US markets and eliminate all our remaining protection against US competition and remove all farm support against Australian competition. The outcome of negotiations meant these estimates wildly overstated our gains.

AUSTRALIA-JAPAN ECONOMIC PARTNERSHIP The only "facts" available publicly at the end of negotiations were based on projections made in 2005, before negotiations began, of what Australia would gain if all barriers between the two countries were removed immediately. The potential GDP gains projected for Australia based on that scenario were $39 billion over 20 years. This estimate of potential gains was still being used by the Department of Foreign Affairs and Trade to support the agreement after it was signed, as though it reflected the actual outcome for Australia. We now know the outcome of negotiations bears no relation to the unrealistic scenario that provided the basis for support for the agreement.

AUSTRALIA-CHINA FREE TRADE AGREEMENT As happened in negotiations with the US, the all-important distinction between possible gains (as measured in the initial projections) and the actual outcome of (future) negotiations became blurred. This is evident, for instance, in the study's conclusion that "Australian merchandise exports to China are estimated to increase by $4.3 billion or 14.8 per cent in 2015 as a result of the FTA". Intentionally or otherwise, the effect was to encourage a quite positive public expectation about the outcome of negotiations that had no basis in fact. This is probably inevitable when the information available to the community is deliveredby officials whose job it is tosell the agreements.

Document AUSTLN0020160823ec8o0005g

